Internal Revenue Service

memorandum

date: MAY 19 1989

to: District Counsel, San Francisco CC:SF
Attn: Margaret S. Rigg

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: [redacted]

This is in response to your memorandum dated March 21, 1989, as supplemented by the additional documents provided by your memorandum dated March 31, 1989.

ISSUE

Whether the same share requirement of the small partnership exception was satisfied with respect to [redacted]'s [redacted] taxable year.

CONCLUSION

Since the partners' respective interests in profits and losses were different and both income and loss items were reported by [redacted] for the [redacted] taxable year, the same share requirement was not satisfied. Additionally, there was a special allocation of income in favor of the general partner. Hence, the small partnership exception does not apply and [redacted] should have been classified as a TEFRA partnership for the [redacted] taxable year.

FACTS

For the [redacted] taxable year, [redacted] was a partnership with [redacted] partners, all of which were natural persons. Notwithstanding the fact that the partners' respective interests in profits and losses were different, the Service determined that the small partnership exception applied and issued statutory notices of deficiency to at least some of the partners of [redacted] No notice of final partnership administrative adjustment (FPAA) was ever issued with respect to [redacted] for the [redacted] taxable year, and it is our understanding that the statute of limitations for that year has expired.

DISCUSSION

In your March 21, 1989 memorandum, you proposed to concede the above-captioned case with respect to the [redacted] taxable year. For the reasons discussed below, we agree with your conclusion.

The TEFRA partnership provisions, which are contained in sections 6221-6233, provide for unified audit and litigation procedures at the partnership level. For the [redacted] taxable year, all partnerships are subject to the TEFRA partnership procedures unless they qualify for the small partnership exception. If a partnership is subject to the TEFRA partnership procedures, except under certain circumstances that are not applicable herein, the deficiency procedures do not apply. I.R.C. § 6230(a). Moreover, if the TEFRA partnership procedures are not followed, any premature assessment or collection activity may be enjoined. I.R.C. § 6225(b). Thus, in the instant case, the question of whether the statutory notice of deficiency that was issued to the [redacted] is valid turns on whether [redacted] qualifies for the small partnership exception.[1]

The small partnership exception is set forth in section 6231(a)(1)(B)(i). Pursuant to that section, a partnership that has 10 or fewer partners, each of whom is a natural person (other than a nonresident alien) or an estate, and each partner's share of each partnership item is the same as the partner's share of every other item, is excepted from the TEFRA partnership provisions. Since in the instant case the partnership had only [redacted] partners, each of whom was a natural person, the relevant inquiry is whether the same share requirement was satisfied.

The operation of the same share requirement was considered by the Tax Court in Z-Tron Computer Research and Development Program v. Commissioner, 91 T.C. 258 (1988) and Harrell v. Commissioner, 91 T.C. 242 (1988). In those cases, the court set forth a bright line test for determining whether the same share requirement has been satisfied. Specifically, under the bright line test, the determination of whether each partner's share of each partnership item is the same as that partner's share of every other item is to be made by examining the partnership return and the schedule K-1's, as filed and amended prior to the commencement of the audit, considering only those items reported

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[1] Notwithstanding the small partnership exception, a partnership may elect to have the TEFRA partnership provisions apply for a given taxable year and all subsequent years. I.R.C. § 6231(a)(1)(B)(ii). In the instant case, there is no indication that such an election was made on behalf of [redacted].

for the year in issue. [2] Consequently, in applying the bright line test, it is necessary to look not only at box D of the schedule K-1, which indicates the partner's share of profits and losses on a percentage basis, but also to look at each item reported on the partnership return and schedule K-1, to determine whether each reported item was allocated in accordance with the proper percentages.

In the instant case, it is clear that the same share requirement has not been satisfied. This is because a review of the schedule K-1's reveals that each partner's interest in profits is different than their interest in losses and both income and loss items were reported by the partnership for the [redacted] taxable year. For example, the [redacted] had an [redacted] percent interest in profits and a [redacted] percent interest in losses, and were allocated their pro rata share of investment interest and expense, amortization deduction, miscellaneous expenses, and income from the recapture of investment tax credit. Additionally, the same share requirement was violated because there was a special allocation of [redacted] percent of the profits to the general partner as provided for in Articles [redacted] and [redacted] of the limited partnership agreement and paragraph [redacted] of the certificate of limited partnership. See the schedule K-1 for the general partner, [redacted]. Based upon the information that you provided, it does not appear as if the exception contained in Temp. Treas. Reg. § 6231(a)(1)-1T(a)(3) is applicable here. Accordingly, since the same share requirement has not been satisfied, [redacted] should have been treated as a TEFRA partnership for the [redacted] taxable year. As a result, the inclusion of the [redacted] adjustments in a statutory notice of deficiency was improper and the Tax Court lacks jurisdiction to consider those adjustments. See Munro v. Commissioner, 92 T.C. No. 6 (Jan. 23, 1989); Maxwell v. Commissioner, 87 T.C. 783 (1986). Therefore, we agree with your conclusion that the above-captioned case should be conceded with respect to the [redacted] adjustments for the [redacted]

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[2] The bright line test is potentially inconsistent with the temporary regulations, which provide an exception for disproportionate allocations that are made due to section 704(c) or similar principles, or as a result of basis adjustments under sections 754, 743 or 734. See Temp. Treas. Reg. § 6231(a)(1)-1T(a)(3). It is the Service's position that in determining whether the same share requirement has been satisfied, the exception provided by the temporary regulations must be taken into account after applying the bright line test.

taxable year. However, it is important to note that in order to dispose of this case, it will be necessary to file a motion to dismiss for lack of jurisdiction; [3] the court cannot enter a decision in this case, even if the decision were to indicate that there is no deficiency for the [redacted] taxable year.

If you have any questions concerning this matter, please contact Henry Schneiderman at (FTS) 566-3107.

MARLENE GROSS

By: _____
HENRY S. SCHNEIDERMAN
Technical Assistant to the
Assistant Chief Counsel
(Tax Litigation)

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[3] Pursuant to Notice N(35)(24)00-1 dated April 28, 1987, all Motions to Dismiss relating to TEFRA partnerships must be sent to the Tax Litigation Division for review prior to being filed with the Tax Court.